LIBRARY
SUPREME COURT, U. S.

Supreme Court, U. S.
FILED
OCT 26 1973
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-575

ANITA B. BRODY,

Petitioner,

v.

CHEMICAL BANK, MANUFACTURERS HANOVER TRUST COMPANY, IRVING TRUST COMPANY, CHASE MANHATTAN BANK, N.A., BANK OF MONTREAL, GIRARD TRUST BANK and THE FIDELITY BANK,

Respondents,

and

PENNSYLVANIA COMPANY,

Defendant.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

RALPH L. MCAFEE,
Counsel for Respondents
Chemical Bank and The Fidelity Bank,
One Chase Manhattan Plaza,
New York, N. Y. 10005

RICHARD S. SIMMONS,
ANDREW P. TASHMAN,
LAWRENCE R. SAMUELS,
CRAVATH, SWAINE & MOORE,
One Chase Manhattan Plaza,
New York, N. Y. 10005,
Of Counsel.

PEPPER, HAMILTON & SCHEETZ,
2001 The Fidelity Building,
Philadelphia, Pennsylvania 19109,
Of Counsel for
The Fidelity Bank.

(Continued on Reverse Side)

(Continued from Reverse Side)

HORACE J. MCAFEE,
Counsel for Respondent Manufacturers Hanover Trust Company,
One Battery Park Plaza,
New York, N. Y. 10004

ROY L. REARDON,
EDWARD C. MENDRZYCKI,
SIMPSON THACHER & BARTLETT,
One Battery Park Plaza,
New York, N. Y. 10004
Of Counsel.

STEPHEN A. WEINER,
Counsel for Respondent Irving Trust Company,
40 Wall Street,
New York, N. Y. 10005

WINTHROP, STIMSON, PUTNAM & ROBERTS,
40 Wall Street,
New York, N. Y. 10005
Of Counsel.

ANDREW J. CONNICK,
Counsel for Respondents Chase Manhattan Bank, N.A. and Girard Trust Bank,
One Chase Manhattan Plaza,
New York, N. Y. 10005

BRISCOE R. SMITH,
NORMAN R. NELSON,
MILBANK, TWEED, HADLEY & MCCLOY,
One Chase Manhattan Plaza,
New York, N. Y. 10005.
Of Counsel.

DRINKER BIDDLE & REATH,
1100 Philadelphia National Bank Building,
Broad and Chestnut Streets,
Philadelphia,
Pennsylvania 19107.
Of Counsel for Girard Trust Bank.

JOHN V. DOWNEY,
Counsel for Respondent Bank of Montreal,
84 William Street,
New York, N. Y. 10038

BRADY & TARPEY, P.C.,
84 William Street,
New York, N. Y. 10038
Of Counsel.

October 26, 1973.

TABLE OF CONTENTS

	PAGE
TABLE OF AUTHORITIES	i
QUESTION PRESENTED	1
STATEMENT OF THE CASE	2
ARGUMENT	4
I. THE DISMISSAL OF THE REPRESENTATIVE COUNTS WAS CORRECTLY AFFIRMED	4
II. THE DETERMINATION OF A QUESTION OF STATE LAW BY THE COURT OF APPEALS OUGHT NOT TO BE DISTURBED	7
III. THERE IS NO CONFLICT AMONG THE CIRCUITS	7
CONCLUSION	9

Table of Authorities

CASES:

Beloff v. *Consolidated Edison Co.*, 300 N.Y. 11, 87 N.E.2d 561 (1949)	6
Bernhardt v. *Polygraphic Co. of America*, 350 U.S. 198 (1956)	7
Borak v. *J.I. Case Co.*, 317 F.2d 838 (7th Cir. 1963), *aff'd*, 377 U.S. 426 (1964)	8
Commissioner v. *Estate of Bosch*, 387 U.S. 456 (1967)	7
Estate of Spiegel v. *Commissioner*, 335 U.S. 701 (1949)	7
Gooding v. *Wilson*, 405 U.S. 518 (1972)	7
Green v. *Victor Talking Mach. Co.*, 24 F.2d 378 (2d Cir.), *cert. denied*, 278 U.S. 602 (1928)	6

PAGE

CASES:

Magnum Import Co. v. *Coty*, 262 U.S. 159 (1923).. 9

Niles v. *New York Central and Hudson River R.R.*, 176 N.Y. 119, 68 N.E. 142 (1903) 6

Ragan v. *Merchants Transfer & Warehouse Co.*, 377 U.S. 530 (1949) 7

Ruhlin v. *New York Life Insurance Co.*, 304 U.S. 202 (1938) 8

Spalitta v. *National American Bank*, 444 F.2d 291 (5th Cir.), *cert. denied*, 404 U.S. 883 (1971) 8

TEXT:

13 *Fletcher, Private Corporations* § 5913 (perm. ed. rev. 1970) 5-6

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-575

ANITA B. BRODY,

Petitioner,

v.

CHEMICAL BANK, MANUFACTURERS HANOVER TRUST COMPANY, IRVING TRUST COMPANY, CHASE MANHATTAN BANK, N.A., BANK OF MONTREAL, GIRARD TRUST BANK AND THE FIDELITY BANK,

Respondents,

and

PENNSYLVANIA COMPANY,

Defendant.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

QUESTION PRESENTED

Does a preferred shareholder have a claim for fraud on the corporation resulting in a loss to the corporation's general assets which allegedly indirectly diminishes the

market value of the preferred shares and the corporation's ability to pay dividends on such shares, when recovery on behalf of the corporation would make it and its shareholders whole?

STATEMENT OF THE CASE

By a complaint filed June 14, 1971, plaintiff, a holder of nonvoting cumulative preferred stock of Pennsylvania Company ("Pennco"), commenced this action against respondents and other banks* ("the banks"), as both a derivative action on behalf of Pennco and as a class action on behalf of herself and of all other preferred shareholders of Pennco similarly situated.

The amended complaint alleged that prior to the reorganization of the Penn Central Transportation Company ("Railroad"), the banks, knowing of Railroad's dire financial condition and unwilling to lend funds directly to Railroad, conspired with Railroad to lend $50,000,000 to Pennco, all of whose common stock was owned by Railroad. Pennco was thereupon caused in May or June of 1970 to lend the funds so borrowed to Railroad, which it is alleged, the banks knew or had reason to know would be unable to repay Pennco.

Plaintiff, in counts one and three of the amended complaint, alleged derivative claims under section 17(a) of the Securities Act of 1933 (15 U.S.C. § 77q(a)) and common law. Counts five and six** pleaded that the same alleged facts gave rise to individual shareholder claims for damages under common law, which plaintiff purported to assert on her own behalf and on behalf of all Pennco preferred shareholders similarly situated.

---

* The action was dismissed as to three bank defendants, Mellon National Bank and Trust Company, Pittsburgh National Bank and National Boulevard Bank of Chicago, for improper venue.

** Counts two and four of the amended complaint, alleging violations of the Interstate Commerce Act, were discontinued.

Plaintiff demanded judgment against the banks (1) for rescission of the loan transactions, requiring the banks to look to Railroad and not to Pennco for repayment of the $50,000,000 loan, (2) for damages to Pennco and to Pennco's preferred shareholders, (3) for the profits and benefits gained by the banks and Railroad and (4) for counsel and accounting fees.

On July 26, 1972, the United States District Court for the Southern District of New York (Gagliardi, J.) dismissed the derivative claims (counts one and three of the amended complaint) "for failure to make a demand as required by Rule 23.1 Fed. R. Civ. P." (Appx. B, pp. 8a-17a.*) The district court dismissed the representative claims on behalf of the preferred shareholders (counts five and six of the amended complaint) for failure to state a claim.

The district court held that the allegation that the loan transaction had impaired the financial structure of the corporation was insufficient to state a claim on behalf of the plaintiff and the alleged class of preferred shareholders because:

> "The primary consequence of the allegedly fraudulent loan transactions was the incurrence of a $50,000,000 debt by Pennco; any subsequent injury to the shareholders by virtue of a diminution in the value of corporate stock was secondary, and does not give rise to a direct stockholder action." (Appx. B, p. 15a.)

Similarly, the alleged impairment of Pennco's dividend paying ability was held not to state a claim on behalf of the plaintiff and the alleged class of preferred shareholders because:

> ". . . the injury is to the profit potential of Pennco itself, by reason of the allegedly fraudulent loan transactions. The paramount injury being to the

* References are to the appendices to the petition for a writ of certiorari.

corporation, the appropriate vehicle for recovery is either a direct corporate action or a derivative suit in the right of the corporation." (Appx. B, p. 16a.)

On July 3, 1973, the second circuit unanimously affirmed the dismissal of the representative counts on the decision below. It remanded the derivative counts to allow the plaintiff an opportunity to correct the deficiencies in those claims by repleading.

On August 2, 1973, the court of appeals denied defendants' petition for rehearing with respect to that portion of the court's decision which permitted plaintiff to replead the derivative claims.

Petitioner now asks this Court to review, by writ of certiorari, the unanimous decision of the court of appeals, only in so far as it affirmed the dismissal by the district court of petitioner's representative claims.

ARGUMENT

POINT I

THE DISMISSAL OF THE REPRESENTATIVE COUNTS WAS CORRECTLY AFFIRMED.

Petitioner's contention that the lower federal courts disregarded New York common law in dismissing the representative claims (Pet. pp. 11-13) is simply wrong. Examination of the district court's opinion indicates that Judge Gagliardi took careful account of New York common law. (Appx. B, pp. 13a-16a.)

Petitioner's contention that the lower federal courts disregarded New York common law rests on the argument that "the same acts which give rise to a derivative action on behalf of a corporation can also give rise to an action on behalf of individual stockholders if they have

been separately damaged". (Pet. p. 11). The district court recognized that "in certain instances a single injury may give rise to both corporate and individual actions. . . ." (Appx. B, p. 14a.) But the court went on to hold that the alleged fraud on Pennco did not give rise to a representative action on the part of the preferred shareholders, regardless of the allegations of injury to the financial structure of the corporation, which it was alleged endangered the petitioner's investment and her right to dividends. Where the alleged fraud results in a diminution of corporate assets and thus indirectly causes a reduction in the monetary value of the stock of the corporation, the paramount injury is to the corporation and "the appropriate vehicle for recovery is either a direct corporate action or derivative suit in the right of the corporation". (Appx. B, pp. 14a-16a.)

There is not the slightest question that the district court examined and applied New York law, took into account the legal argument put forward before this Court by petitioner as evidence of error on the part of the district court and held, on the basis of ample authority, that the claims asserted by petitioner do not state a representative claim. On the basis of that opinion, a unanimous court of appeals affirmed the dismissal of the representative claims. Petitioner has not cited a single New York case that is in conflict with this holding.

Any injury to a corporation's general assets necessarily diminishes the value of every shareholder's interest but every injury to a corporation does not give rise to a claim on the part of the shareholders. It is a rule of general applicability that:

> "Generally, a stockholder cannot sue in his own name, and in his own behalf, to recover for any loss resulting from depreciation of the value of his stock, as the result of an injury to the corporation itself.

> This is true although the act complained of was done with the specific intent of injuring plaintiff as a stockholder. Likewise, the fact that the plaintiff claims to be the sole minority stockholder does not give him the right to maintain a personal action." 13 *Fletcher, Private Corporations* § 5913 (perm. ed. rev. 1970) (footnotes omitted). *Accord, Green* v. *Victor Talking Mach. Co.*, 24 F.2d 378, 380 (2d Cir.), *cert. denied*, 278 U.S. 602 (1928).

Nor can the corporate injury be converted into the injury of individual shareholders by allegations of mismanagement by corporate officers or major shareholders. Thus in *Niles* v. *New York Central and Hudson River R.R.*, 176 N.Y. 119, 68 N.E. 142 (1903), allegations that a corporation's major shareholders and directors had "actively participated in the depletion of the company's treasury and in a sacrifice of the company's property, thus depriving the stockholders and the creditors of that which belonged to them" (176 N.Y. at 124, 68 N.E. at 144), were held to state a claim in favor of the corporation and not the individual shareholder.

The same result was reached in *Beloff* v. *Consolidated Edison Co.*, 300 N.Y. 11, 87 N.E.2d 561 (1949) in which the New York Court of Appeals rejected a shareholder's attempt to state a claim for tortious injuries similar to those alleged here.

> "The second, third and fourth causes of action in the complaint (each brought by plaintiffs on their own behalf and in behalf of Brooklyn Edison) set out alleged transactions between Consolidated Edison and Brooklyn Edison, before the merger, in which transactions, it is said, the former, dominating the latter, took advantage of that dominant position to benefit itself to the latter's detriment. Insofar as those three counts are pleaded by plaintiffs individually they are plainly not maintainable since no individual stockholder has any such right of action (*Niles* v. *New York Central & Hudson Riv. R.R. Co.*, 176 N.Y. 119)." 300 N.Y. at 18, 87 N.E.2d at 564.

POINT II

THE DETERMINATION OF A QUESTION OF STATE LAW BY THE COURT OF APPEALS OUGHT NOT TO BE DISTURBED.

This Court has held on numerous occasions that where, as in this case, the issue presents solely a question of state law the determination of local law by the court of appeals will not be disturbed. *Commissioner* v. *Estate of Bosch*, 387 U.S. 456, 462 (1967); *Ragan* v. *Merchants Transfer & Warehouse Co.*, 337 U.S. 530, 534 (1949); *Estate of Spiegel* v. *Commissioner*, 335 U.S. 701, 707-708 (1949).

Where, as here, the judges in the lower federal courts regularly decide cases involving the law of the particular state in question and where those judges were practitioners in that state before going on the bench, the views of these judges concerning state law questions are "necessarily persuasive" (*Gooding* v. *Wilson*, 405 U.S. 518, 524 (1972)) and are deserving of "special weight". *Bernhardt* v. *Polygraphic Co. of America*, 350 U.S. 198, 204 (1956).

POINT III

THERE IS NO CONFLICT AMONG THE CIRCUITS.

Petitioner asserts that this Court should review the determination of the lower federal courts in this case on the ground that it is in "conflict" with decisions in other circuits (Pet. pp. 6-10). Petitioner alleges, however, that the question of whether the amended complaint states a representative claim is solely a question of New York state law (Pet. p. 11). Obviously, decisions of other courts of appeals interpreting the law of other states, even if they were on point, would not create any conflict which this Court ought to resolve. Neither of the two cases cited by

petitioner as being in conflict with the decision of the courts below is based on New York law and consequently neither of those cases is in conflict with the decision in this case. Decisions of courts of appeals interpreting the laws of different states do not give rise to that type of conflict which would form a basis for review by this Court by a writ of certiorari. *Ruhlin* v. *New York Life Insurance Co.*, 304 U.S. 202, 206 (1938).

In any event, the cases cited by petitioner as evidence of a conflict between the courts of appeals are not in conflict with either New York law or general principles governing shareholder actions. *Borak* v. *J.I. Case Co.*, 317 F.2d 838 (7th Cir. 1963), *aff'd*, 377 U.S. 426 (1964), relied upon by petitioner as evidence of the alleged conflict (Pet. pp. 6-7), was considered and distinguished by the district court (Appx. B, pp. 14a-15a):

> "*Borak* v. *J.I. Case Co.*, 317 F.2d 838 (7th Cir. 1963), *aff'd*, 377 U.S. 426 (1964) relied upon by the plaintiff is clearly inapposite. The *Borak* case did not involve a diminution in corporate assets with a resulting drop in the monetary value of stock, but a reduction in individual proportionate ownership of a corporation as a result of the issuance of new shares in violation of preemptive rights. The distinction between these cases is clear." (Appx. B, p. 14a).

The only other case on which petitioner relies is *Spalitta* v. *National American Bank*, 444 F.2d 291 (5th Cir.), *cert. denied*, 404 U.S. 883 (1971), where the fifth circuit held that the facts alleged gave rise to both derivative and representative causes of action, but nothing in the holding of that case is in conflict with the rule of New York law that injury to the corporation which only results in injury to a shareholder indirectly, by reduction in the monetary value of shares, impairment of the financial structure of the corporation or inability to pay dividends, states only a cor-

porate claim to be asserted directly by the corporation or derivatively by its shareholders on its behalf.

CONCLUSION

Chief Justice Taft, commenting on the Supreme Court's certiorari jurisdiction said, "The jurisdiction was not conferred upon this Court merely to give the defeated party in the Circuit Court of Appeals another hearing". *Magnum Import Co.* v. *Coty*, 262 U.S. 159, 163 (1923).

For the reasons stated, the petition for a writ of certiorari should be denied.

October 26, 1973.

Respectfully submitted,

RALPH L. MCAFEE,
Counsel for Respondents Chemical Bank and The Fidelity Bank,
One Chase Manhattan Plaza,
New York, N. Y. 10005

RICHARD S. SIMMONS,
ANDREW P. TASHMAN,
LAWRENCE R. SAMUELS,
CRAVATH, SWAINE & MOORE,
One Chase Manhattan Plaza,
New York, N. Y. 10005,
Of Counsel.

PEPPER, HAMILTON & SCHEETZ,
2001 The Fidelity Building,
Philadelphia, Pennsylvania 19109,
Of Counsel for The Fidelity Bank.

HORACE J. MCAFEE,
Counsel for Respondent Manufacturers Hanover Trust Company,
One Battery Park Plaza,
New York, N. Y. 10004

ROY L. REARDON,
EDWARD C. MENDRZYCKI,
SIMPSON THACHER & BARTLETT,
One Battery Park Plaza,
New York, N. Y. 10004
Of Counsel.

STEPHEN A. WEINER,
Counsel for Respondent
Irving Trust Company,
40 Wall Street,
New York, N. Y. 10005

WINTHROP, STIMSON, PUTNAM
& ROBERTS,
40 Wall Street,
New York, N. Y. 10005
Of Counsel.

ANDREW J. CONNICK,
Counsel for Respondents
Chase Manhattan Bank, N.A.
and Girard Trust Bank,
One Chase Manhattan Plaza,
New York, N. Y. 10005

BRISCOE R. SMITH,
NORMAN R. NELSON,
MILBANK, TWEED, HADLEY
& MCCLOY,
One Chase Manhattan Plaza,
New York, N. Y. 10005.
Of Counsel.

DRINKER BIDDLE & REATH,
1100 Philadelphia National
Bank Building,
Broad and Chestnut Streets,
Philadelphia,
Pennsylvania 19107.
Of Counsel for
Girard Trust Bank.

JOHN V. DOWNEY,
Counsel for Respondent Bank
of Montreal,
84 William Street,
New York, N. Y. 10038

BRADY & TARPEY, P.C.,
84 William Street,
New York, N. Y. 10038
Of Counsel.